

The Government Executive Series

Outsourcing in Government: Pathways to Value


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Foreword

Last year Accenture's research focused on the current state of outsourcing in government and emerging opportunities for transformation through outsourcing. Our 2002 study, *Outsourcing in Government: The Path to Transformation*, answered the following questions: What are the prospects for outsourcing in government today? How extensively are government agencies using outsourcing? What objectives are they pursuing, what results are they achieving, and what lessons can we learn from their experiences to date?

We concluded that outsourcing in the public sector is particularly challenging but that some governments around the world had used outsourcing for remarkable results. Forward-thinking governments had established a management framework through sound policy that enabled good outsourcing practices, and a few leaders had achieved breakthrough benefits through what we call transformational outsourcing.

In 2003, we have expanded the scope of our study. Prior to this study, Accenture had found some readily available information about very broad trends in government outsourcing. However, we had found few examples of specifics to help governments structure and manage outsourcing for the best outcomes. We set out to gain a detailed understanding of the ingredients in successful outsourcing. Further, we wanted to look across the world's governments to see the similarities and differences in their outsourcing experiences. Our objective was to offer well-grounded recommendations to help all government executives improve their outsourcing effectiveness.

We discovered that outsourcing success does not have the same meaning for every country. Rather, countries seem to be following one of two separate and distinct paths—or trajectories—of increasing outsourcing maturity, depending on their end goals. One trajectory leads to greater efficiency of existing operations and is marked by extensive use of conventional forms of outsourcing, such as IT infrastructure. The other leads to organizational transformation and is marked by more extensive use of higher value-added outsourcing forms, in particular, business process outsourcing.

This report, *Outsourcing in Government: Pathways to Value*, taps into the experience of the executives who are helping drive their agencies toward one of these two strategic endpoints. We have distilled their leading practices and present them here, with stories of their successes and stumbling blocks, for government executives embarking on their own outsourcing trajectory.

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Introduction

Accenture's goals for the study

In 2002, Accenture interviewed public-sector executives and outsourcing experts from around the world to understand the opportunities for outsourcing, the challenges and the path forward. The resulting report, *Outsourcing in Government: The Path to Transformation*, provided a base of understanding about the state of outsourcing in government today, as well as actionable advice from outsourcing leaders to help other government executives achieve high-value results.

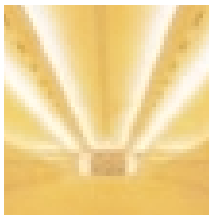
In 2003, we expanded our scope. We set out to identify the critical factors that contribute to successful outsourcing and to explore these individual elements in greater detail. We wanted to survey a broad cross-section of national governments to see how they had mastered these elements and to identify consistent outsourcing themes around the world.

As we embarked on our research for this report, we laid out an overview of the outsourcing landscape

based on our previous research. We used that as the starting point for a detailed exploration of the practices that contribute to effective outsourcing. We interviewed government executives in 22 countries around the world to get their perspectives, identify common roadblocks to progress and crystallize leading practices. We examined the topic from multiple perspectives, employing a number of research approaches, including quantitative surveys and qualitative interviews. We spoke with central government officials to understand the top-level view of outsourcing in their national government, as well as senior executives in charge of prominent initiatives in each country. Finally, we added our own perspective from our extensive research and experience in the area. (See sidebar on page 5 for more details on our research methodology.)

What is outsourcing?

Governments answer the question differently. In the United States, for example, most federal executives focus on jobs. Some use the term outsourcing whenever a private-sector firm does a job that was



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once done by a government employee. Others include new work—jobs that could potentially be done by government employees. When agencies contract out website design, for example, they may call it outsourcing even though their own IT staff has never done any Internet work and no current staff assignments are affected. Some US government executives even use the term outsourcing when customers self-serve in a way that reduces the government's overall workload. The United States Postal Service, for example, calls it outsourcing when customers pre-sort their own mail to take advantage of rate discounts.

Other governments draw a clear distinction between ad hoc "contracting out" and outsourcing. They may contract out short-term assignments or specific projects, but they use the term outsourcing to mean multiyear contracts for entire processes or functions. In the United Kingdom and Australia, for example, most government executives would say it is outsourcing when a public-sector process moves to the private sector. They outsource services and contract for specific outputs.

UK executives also make finer definitional distinctions based on whether assets are owned by the government or the private sector. In a private finance initiative, for example, a private firm invests capital to build and operate a public service.

Do public-sector employees have to move to the private-sector firm for an initiative to qualify as outsourcing? In a word, no. The term outsourcing applies regardless of whether employees are reassigned, retired or transferred to the outsource supplier, or no employees were impacted.

A government's political context strongly affects its use of the term outsourcing. For example, several US states have laws that prohibit outsourcing. These states still hire private firms to do public-sector work, but they don't call it outsourcing. US federal executives would rather talk about "competing" or "sourcing" jobs rather than outsourcing them. The

terminology implies that government employees and private firms have equal opportunities to win the work. The United Kingdom "market tests" or "con-tests" functions to convey the same message. We recognize these sensitivities; therefore, for purposes of this report, we define outsourcing as:

Contracting with a private-sector firm to take responsibility for a function or process for which the government remains accountable.

Our definition excludes short-term project work and stops short of privatization, where the government no longer has accountability for the function. Our definition of outsourcing is consistent with the views of close to 90 percent of the executives we interviewed.

National governments are growing more experienced and sophisticated in outsourcing

Last year we quoted statistics that show outsourcing in government is growing—by as much as 17 percent through 2004 by some estimates.¹ Our research this year reaffirms this trend. Seventy-seven percent of the treasury officials we spoke with rated their government's position on outsourcing as either encouraging or actively encouraging. Additionally, the same proportion of officials expects their country will outsource more functions and processes over the next five years. What we also found, however, is that governments are not just doing more outsourcing; they are aiming for more value-added objectives as well.

¹ International Data Corporation, 2001.



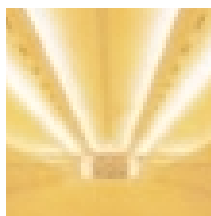
Research methodology

Our research involved both quantitative and qualitative approaches. Accenture's Government practice, working in conjunction with senior researchers from the Accenture Institute for Strategic Change and a network of researchers from an independent agency, the Economist Intelligence Unit (EIU), conducted research across national governments in 22 countries: Australia, Brazil, Brunei, Canada, China*, Finland, France, Germany, Ireland, Italy, Japan, Malaysia, Mexico, The Netherlands, Norway, Portugal, Singapore, South Africa, South Korea, Spain, the United Kingdom and the United States. To maintain a consistent focus and to contain scope, regional and local governments' outsourcing deals were not examined.

For the quantitative component, we surveyed two separate respondent pools. The first was a high-ranking treasury official (or equivalent) from each of the countries who could describe that country's outsourcing history, its attitudes toward outsourcing, its outsourcing effectiveness to date and its future plans. The second pool consisted of executives involved with very large, current information technology and business process outsourcing deals within each country. These were chosen primarily by the monetary value of the deal. The executives were asked to speak to the effectiveness of the deal and the elements that contributed to its success (or failure) to date. In total, 14 treasury surveys and 120 deal surveys were completed.

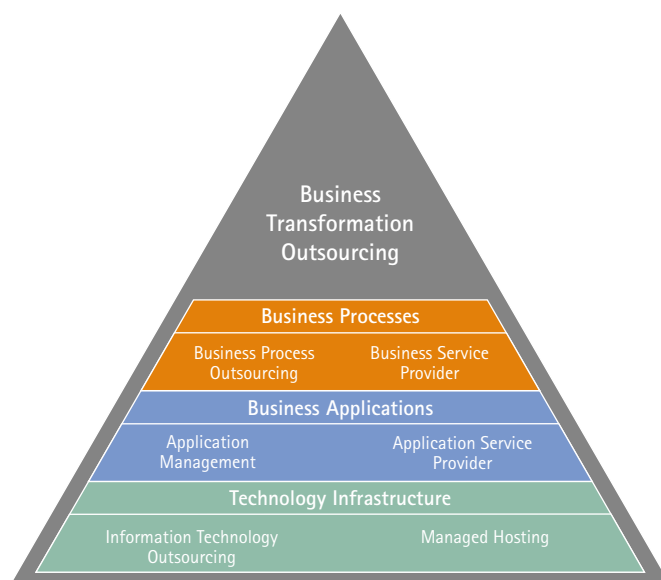
We also conducted in-depth interviews with 28 treasury and deal executives to probe their experiences further and identify effective management practices. We supplemented these interviews with extensive contributor reports from each of the 22 EIU researchers "on the ground" in each country, which included relevant background information, additional perspectives from officials who did not complete surveys, and the researcher's overall assessment of the country's progress to date. All of this material, as well as our own background research, formed the basis of the qualitative component of the research.

*We also researched Hong Kong, Special Administrative Region of the People's Republic of China, for a total of 23 governments.



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Figure 1. The outsourcing value pyramid.



What functions and processes are governments outsourcing? Accenture has developed a useful diagram to illustrate the four main types of IT and business process outsourcing (see Figure 1). Moving up the pyramid, outsourcing increases in strategic value. At the apex, organizations use outsourcing to fundamentally reshape the way they carry out their missions and to achieve notable results in an accelerated time frame. A business transformation outsourcing initiative offers the greatest opportunities for radical improvement because it involves rethinking critical management processes.

Using this pyramid to categorize the outsourcing initiatives we reviewed in our study, we see that much of government IT outsourcing is focused on infrastructure—the lowest level of the outsourcing value pyramid. However, we also see a significant movement up the value ladder. Outsourcing initiatives with a higher potential value—applications and business process outsourcing (BPO)—are as prevalent as IT outsourcing (see Figure 2).

Why are governments outsourcing? For a broad range of reasons. They are increasingly turning to outsourcing to cope with budget pressures, the need to provide existing and additional services in more citizen-friendly ways, and a lack of available expertise and technology to meet these needs. Whatever their reasons, however, executives are realizing that outsourcing is a way to deliver value, not just reduce cost. In fact, they listed the objective of improving service speed or quality most frequently, while reducing costs tied for sixth place. More than 66 percent (78 responses) report they have explicitly outsourced to transform their agency or department (see Figure 3). In a departure from the conventional wisdom, these executives have outsourced activities and processes that are critical to their mission. Eighty-nine percent of respondents rated their outsourced processes as either important or absolutely critical to the mission of their agency. Only 2 percent viewed outsourcing as relatively unimportant to their mission.

Figure 2. Governments now pursue IT applications and business process outsourcing in greater numbers than they have in the past.

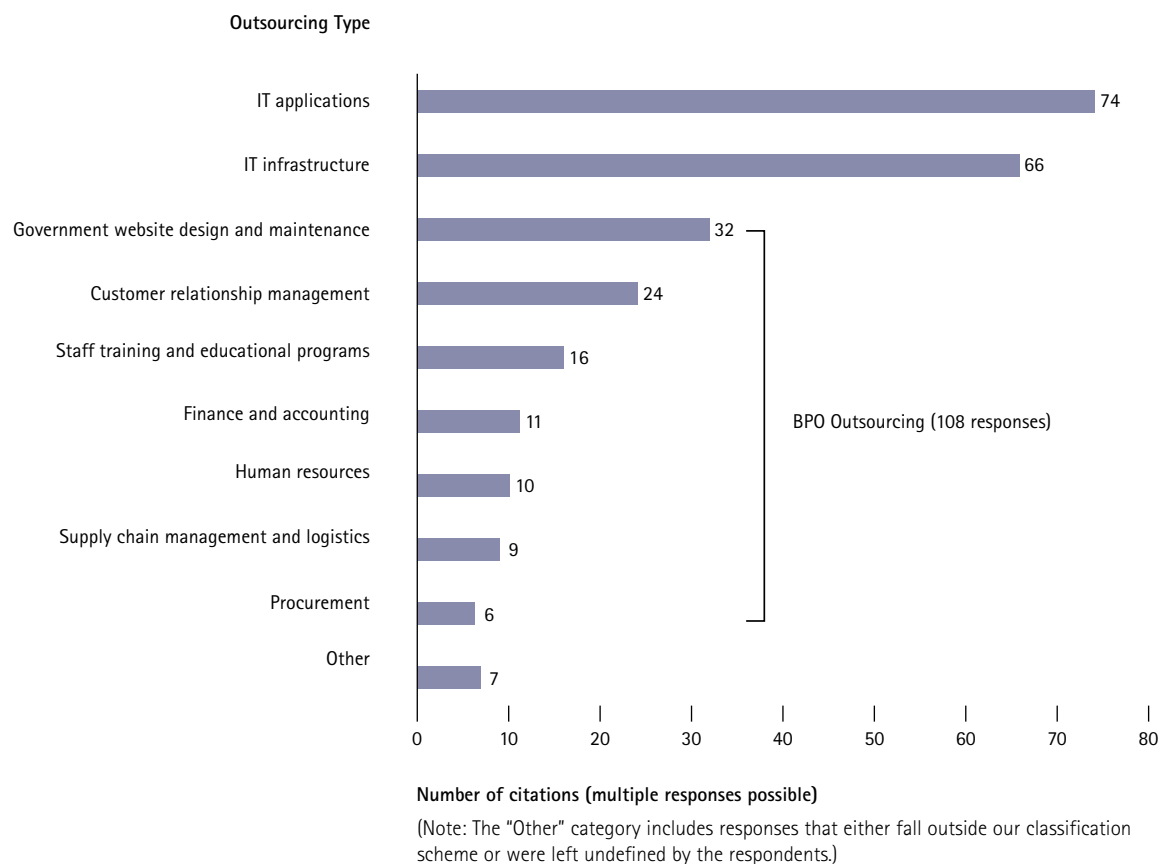
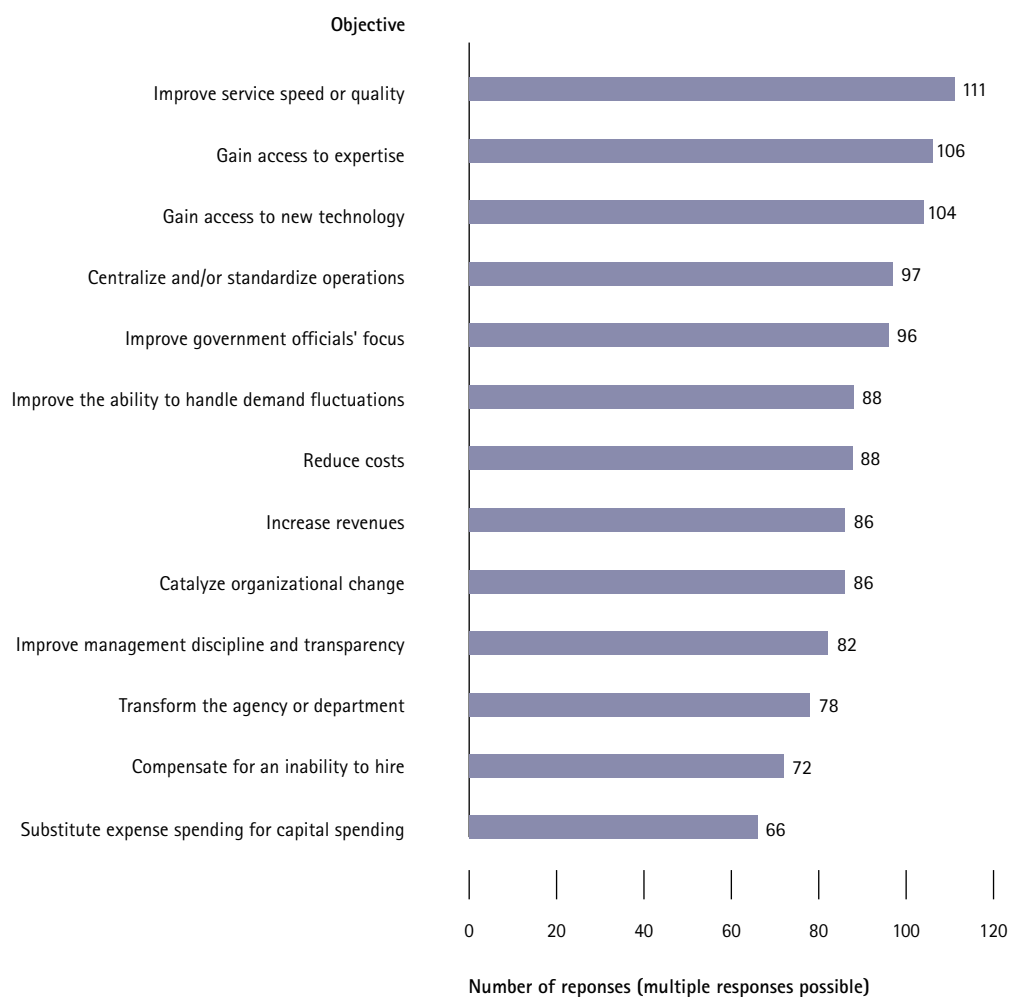
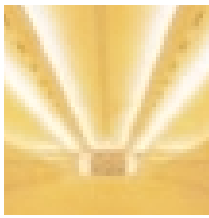


Figure 3. Executives use outsourcing more frequently to add value than to reduce costs.



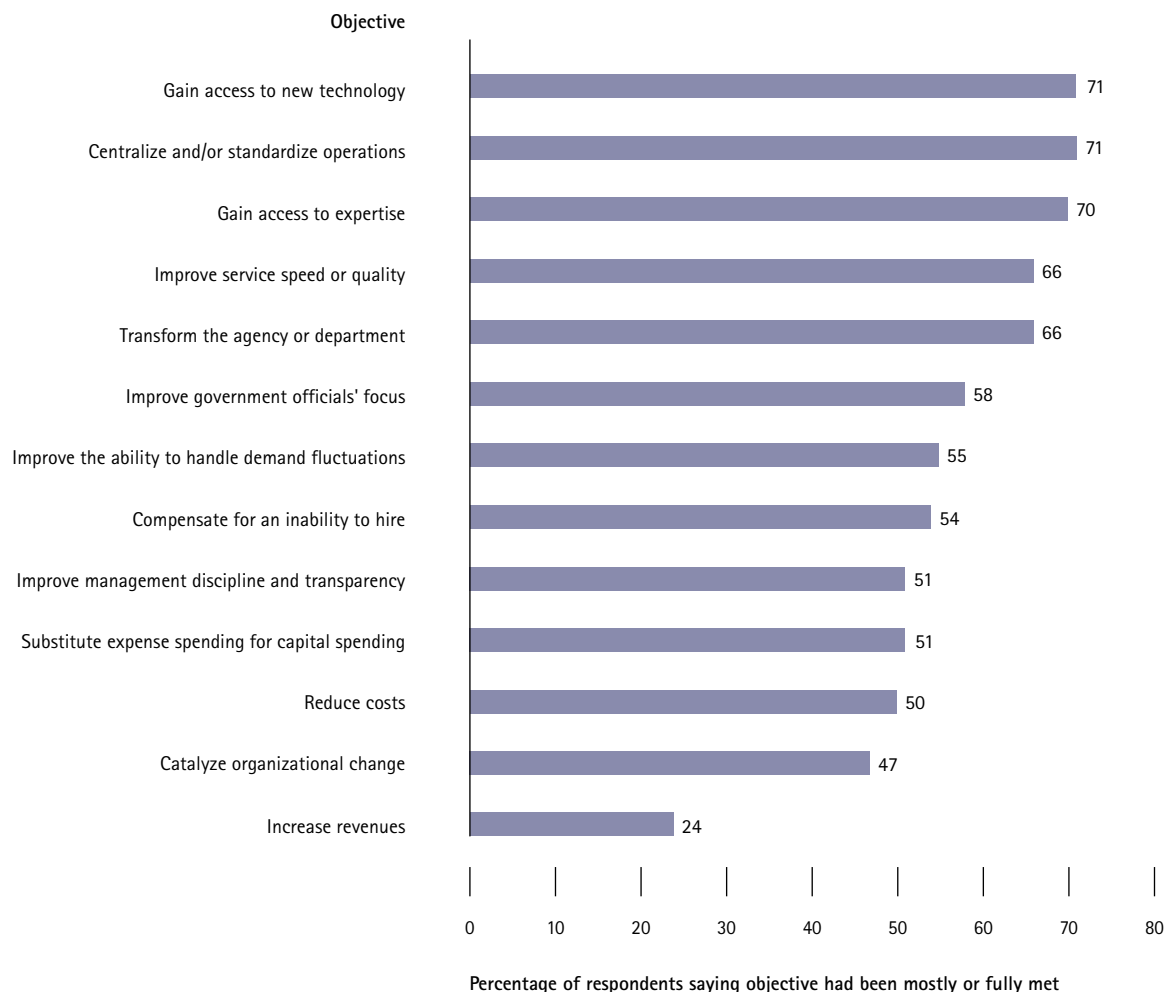


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Just as telling is how well their objectives are being met. Only 50 percent of the survey respondents who counted cost reduction as a top outsourcing driver reported that they were largely or fully meeting their objective. In contrast, those who targeted more value-adding objectives reported more success. For example, executives intending to "gain access to new technology" and "centralize and/or standardize operations" reported the highest percentages of success. In each case, 71 percent stated they had mostly or fully met their objectives in that regard (see Figure 4). In fact, even executives focusing on the most radical outsourcing objective, "transform the agency or department," achieved their goal more frequently than those pursuing cost reductions.

The logical conclusion is that government executives who have wanted to use outsourcing as a way to add value to their organization have been more successful in meeting their objectives than those who had a more single-dimensional focus such as cutting costs. These executives have used their growing experience in outsourcing to chart a higher value path than conventional outsourcing offers. While organizations may once have used outsourcing merely to wring costs out of noncore activities, many government executives have realized that they also can use outsourcing to help them meet more strategic objectives.

Figure 4. Executives achieved their value-adding outsourcing objectives more frequently than cost-reduction goals.



Two outsourcing trajectories

The growth in outsourcing in the public sector is undeniable. The trend toward higher value objectives is equally clear. But these broad directions do not convey the whole story. National governments vary widely in the extent to which they have embraced outsourcing and the ways in which they are using it. Based on our analysis of the data and our in-depth interviews, we conclude that:

The growth in outsourcing is not driven by the same objectives in all cases. National governments' pursuit of value through outsourcing is taking two significantly different trajectories: the efficiency trajectory and the transformational trajectory. These trajectories are set by the countries' unique priorities.

Countries taking the efficiency trajectory generally focus on technology infrastructure and business applications outsourcing as a way to trim costs and redirect capital to more mission-critical functions. A number of these countries have achieved strong positive outcomes through their approach and have little interest in other forms of outsourcing. Countries on the transformational trajectory, which is marked by bold objectives with potentially higher value, typically approach outsourcing as a tool to achieve an aggressive strategic agenda in an accelerated time frame. They are using higher value-added business process outsourcing much more extensively to achieve these aims.

A government's choice of trajectory is just that, a choice. Despite facing similar forces like crushing fiscal pressure or public dissatisfaction that demand reform, governments have chosen different paths. In addition, some governments have not yet decided how they will wield this powerful tool.

We present a more detailed description of these trajectories, as well as synopses of the state of outsourcing in our targeted countries, in the next section, "Outsourcing Maturity: The Global Picture."

Leading executives on both trajectories have developed management practices that contribute to effective outsourcing.

No matter what the ultimate outsourcing objectives, a number of leading practices came to the forefront in our research that we believe will help public-sector executives improve their ability to achieve excellent outcomes. While some of these practices are more applicable in some cases than in others, all of them represent excellent management approaches that can lead to greater outsourcing effectiveness.

The section "Leading Practices in Government Outsourcing" presents innovative outsourcing practices in what we have determined to be the six core capabilities for successful outsourcing management: shaping the relationship to the situation, negotiating and contracting effectively, managing workforce issues, managing the ongoing relationship, ensuring strong performance and institutionalizing flexibility and innovation.

A well-managed transformational initiative can deliver stunning results.

While examples of truly transformational outsourcing in government are still rare, we have found that governments that set out on a transformational trajectory and embrace leading practices in managing the initiative can alter the future of their agencies in profoundly positive ways.

The final section of the report, "Transformation in Action: National Savings and Investments," provides a detailed case study of National Savings and Investments in the United Kingdom—a real-world example of a government organization transforming itself through outsourcing. This example illustrates many of the leading practices we describe in the section preceding it.



Outsourcing maturity: the global picture

When we began our research, our goal was to produce a straightforward ranking of outsourcing maturity by country. We soon discovered, however, that outsourcing maturity was a far more fluid concept than we had originally expected, and that ranking national governments in neat order does not accurately describe the landscape. Our experience gathering data varied from country to country: The willingness to reveal information was greatly influenced by the sensitivity with which the topic was viewed. Likewise, the definition of outsourcing varied within countries. In some countries, for example, respondents used the term outsourcing when a contractor simply designed and built an IT application. This type of ad hoc project fell outside the scope of our definition. We also discovered that outsourcing maturity could be viewed through different lenses; a country that appeared relatively inexperienced from one perspective may look quite different when viewed from another angle.

Our challenge was to weigh these factors and perspectives to develop an accurate overall picture. While we found that strict rankings were impossible, two patterns of outsourcing maturity emerged, with

countries having similar characteristics falling together naturally. These patterns represent outsourcing trajectories, as illustrated in Figure 5. Where a country is placed in this schematic depends on its overall outsourcing objectives, the depth of its experience and its expertise in the different areas of outsourcing practice: shaping the relationship to the situation, negotiating and contracting effectively, managing workforce issues, managing the ongoing relationship, ensuring strong performance and institutionalizing flexibility and innovation. We discuss each of these areas in greater depth in the section of the report entitled "Leading Practices in Government Outsourcing."

The transformational trajectory

The transformational trajectory is driven by bold objectives with high potential value. Countries on this trajectory typically approach outsourcing as a tool to achieve a bold strategic agenda—often driven by a pressing need to reform due to citizen dissatisfaction or severe budget deficits—in an accelerated time frame. For example, the Institute for Social

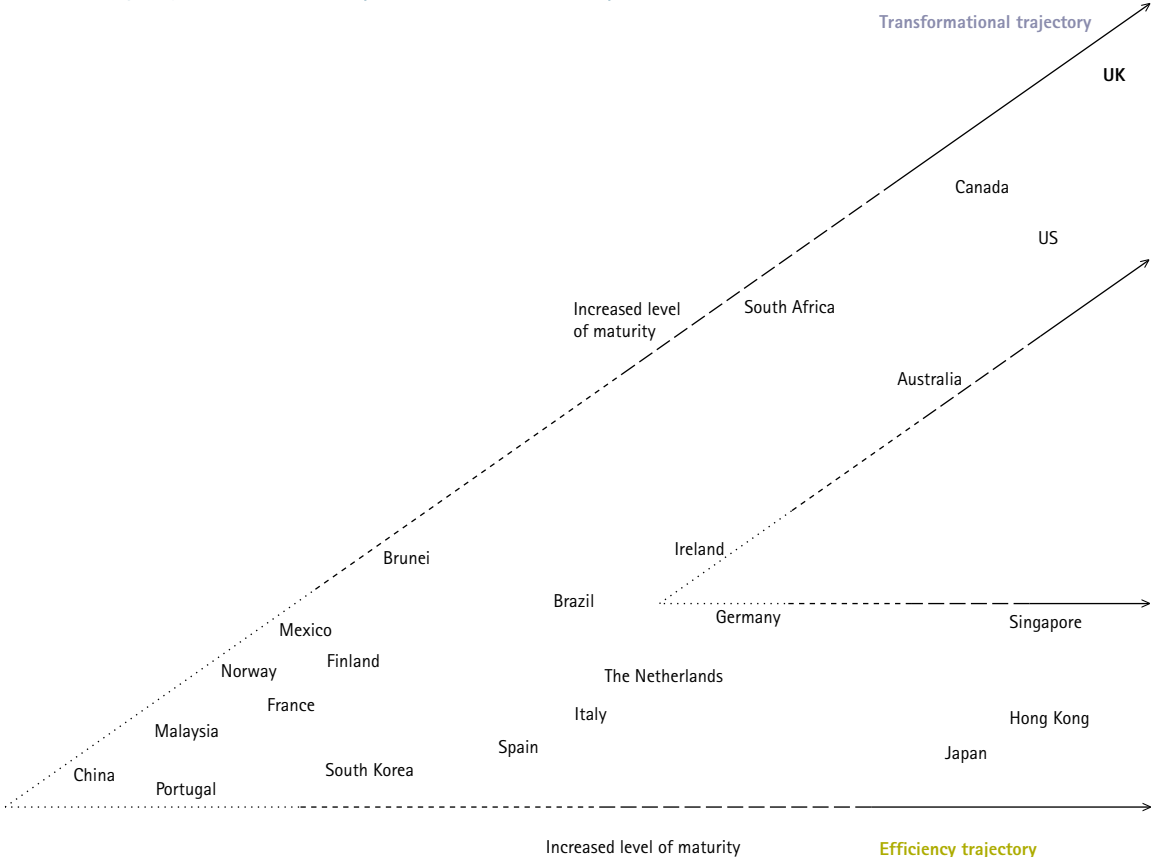
Service in Mexico has used outsourcing to dramatically improve the delivery of health care to government workers. Previously, workers with a health problem had to go to the nearest clinic and wait to be seen. The new outsourced process enables individuals to make appointments ahead of time. While this capability may seem unremarkable to some, it represents a dramatic breakthrough in service for the 10 million individuals affected—representing reductions in wait times from as much as four hours to no more than 15 minutes. (The last section of this report, “Transformation in Action: National Savings and Investments” provides a detailed case study of one agency that dramatically improved its performance by combining a visionary outsourcing initiative with excellent management practices.)

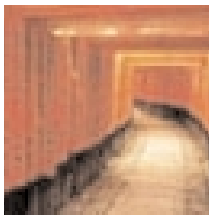
Countries on this transformational trajectory have experience dealing effectively with the inevitable hurdles that arise from more complex and sophisticated initiatives. For example, the United Kingdom had broad and deep experience outsourcing—a large

number of deals running the gamut from infrastructure to business process outsourcing—at the national level and had demonstrated its effectiveness in handling challenging issues like workforce transfer and negative media exposure. Canada and the United States also demonstrated sophistication in these areas, while Australia posed an interesting case.

In the mid-1990s, Australia pioneered “whole of government” IT outsourcing through parliamentary decree. Agencies were clustered together and required to pursue IT infrastructure outsourcing as a group. This bold move could have launched them on a transformational trajectory. However, as the clusters outsourced, the benefits of the policy mandate failed to materialize. Individual agencies resisted the enforced outsourcing, the clusters were unwieldy, and the approach stopped short of the standardization required to tap economies of scale. Its original architect, now retired from government, has acknowledged that it did not work as he had expected. In the midst of the program to outsource

Figure 5. Countries aim toward one of two outsourcing maturity trajectories, based on their outsourcing objectives, their experience and their expertise.





Outsourcing maturity: the global picture

all federal IT infrastructure, the mandate was withdrawn. Agencies are still encouraged to pursue outsourcing, but the individual agencies have more autonomy to implement this revised policy as they see fit. As a result, Australia may reset its trajectory toward more efficiency-oriented goals. It remains to be seen whether individual agencies will use outsourcing aggressively in the future or will shy away from the opportunity, as their experience in the IT outsourcing arena may have tainted their perceptions of its potential.

Countries that have a somewhat lower level of experience with outsourcing, but still hold a transformational agenda, sit at the early stage in the trajectory. On the whole, these countries could be characterized as relatively inexperienced in outsourcing, but we found examples of individual initiatives that had already achieved transformational results, such as Mexico's initiative cited earlier.

The efficiency trajectory

The efficiency trajectory is a path that aims primarily toward cost reduction and productivity. In general, countries on this trajectory focus on technology infrastructure and business applications outsourcing as a way to trim costs and redirect capital to more mission-critical functions. At the more mature end of the spectrum are countries like Singapore and Japan, as well as Hong Kong, where consistent methodologies have led to reported outcomes of great improvements in process efficiency and cost. We found that this focus on efficiency was consistent across the Asia Pacific region.

A number of countries, such as Brazil, Spain and Italy, could not be clearly classified on either of the trajectories. Brazil, for example, has little experience in what we defined as true outsourcing, although there is a central government agency that operates as a shared services center. It handles the IT needs of all other departments and, in turn, outsources to private-sector suppliers. Italy historically had a similar model, but the governmental IT provider has now

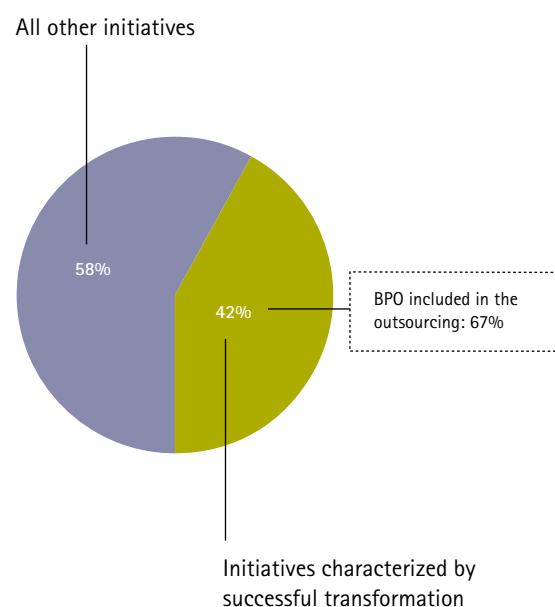
been privatized. While the country has developed extensive experience in outsourcing IT, we found little evidence of business process outsourcing. (Exhibit 1 provides a more detailed synopsis of the state of governmental outsourcing in each of the countries we surveyed.)

The trend toward business process outsourcing

One of the most marked differences between the two trajectories is the extent to which a country embraces business process outsourcing. In 42 percent of the outsourcing initiatives we surveyed, executives reported that they had transformed their agency effectively through outsourcing. In the vast majority of these cases—67 percent—they used BPO to accomplish these profound changes (see Figure 6). Outsourcing infrastructure or applications services alone led less frequently to transformational outcomes. As a result, we clearly associate business process outsourcing with the transformational trajectory.

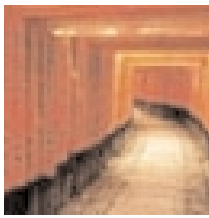
When we looked at how these countries were using outsourcing, we found evidence of a more marked trend toward business process outsourcing among

Figure 6. Successful transformations rely most frequently on business process outsourcing.



A photograph of a bamboo forest. A path made of light-colored gravel or sand leads from the bottom center towards the middle ground, curving slightly to the right. The path is bordered on both sides by a low, rustic fence made of woven straw or reeds, with thin bamboo poles running along the top. The forest is composed of numerous tall, slender bamboo stalks that rise vertically, creating a dense canopy. On the right side of the path, a larger tree with a thick, dark trunk and some green leaves stands out. The lighting is soft and diffused, suggesting an overcast day or a shaded forest interior. The overall color palette is dominated by the greens of the bamboo and the browns of the path and fence.

We found evidence of a
more marked trend toward
business process outsourcing
among countries on a
transformational trajectory.



Outsourcing maturity: the global picture

countries on a transformational trajectory (see Figure 7). In light of the more transformational objectives of these countries, this trend indicates that they are broadening their outsourcing capabilities to reach beyond more traditional IT. The growth of business process outsourcing in the public sector will depend largely on which trajectory the more outsourcing mature countries adopt and the extent to which the more experienced countries retain their managerial will.

A measure of intent and experience

Where countries fall on these trajectories is based on a combination of a number of factors, including the sophistication of their objectives, their ability to manage challenging issues such as workforce transition, their mastery of proven management

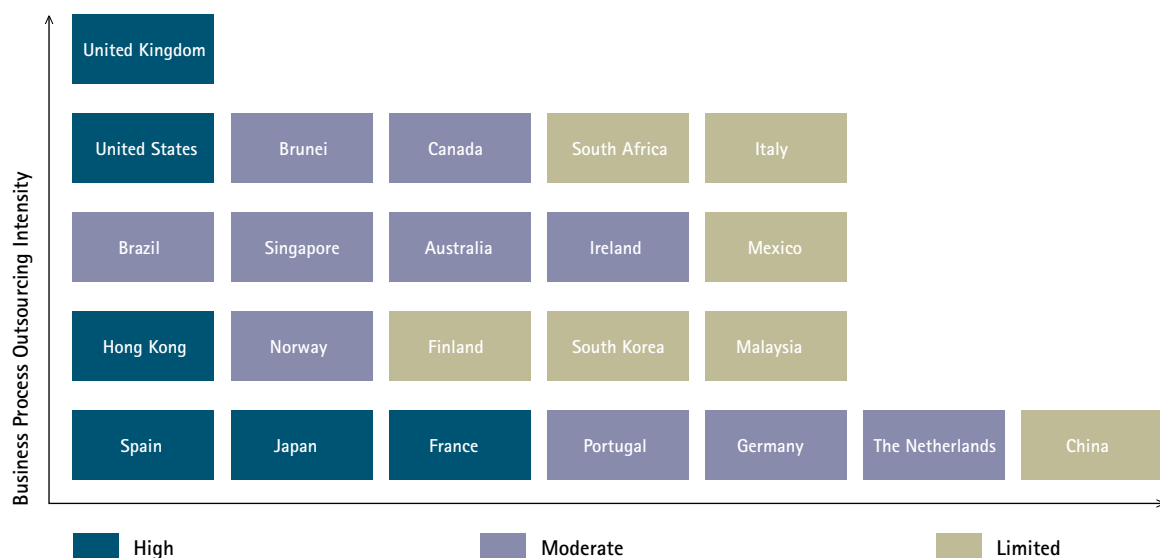
methodologies, the breadth (range of services outsourced) and depth (number of deals) of their outsourcing experience, and their effectiveness to date.

We chose this qualitative approach as the best way of fairly comparing how federal governments around the world are really using outsourcing. While we believe that a transformational trajectory—encompassing a wider range of capabilities—holds the possibility for countries to realize much higher value from their outsourcing, we recognize the merit of many of the more traditional approaches. Many of these initiatives had no intention of driving significant change in government services, but they have met their efficiency objectives remarkably well. And in many cases, the central governments reported no higher aspirations for their outsourcing initiatives in the future.

Figure 7. Grouping of countries based on their trend toward business process outsourcing.

Evidence to support this trend came from survey data about types of outsourcing done in each country, interviews with treasury officials, background research and contributor reports. The amount of BPO experience a country has is indicated by where it falls on the chart, with the top level indicating the most BPO experience. The color coding of the countries represents the strength of the evidence supporting the countries' placements on this chart.

The United Kingdom stands alone in business process outsourcing

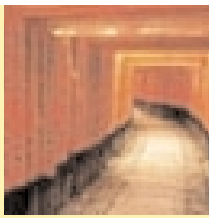


Additionally, our placement of a country on a trajectory does not imply that all initiatives within the government of that country have that particular profile. The United Kingdom, for example, falls close to the endpoint of the transformational trajectory. However, many initiatives within the UK government would not be considered transformational. We want to convey that the government has amassed a portfolio of capabilities that includes not only transformational outsourcing, but also more conventional approaches. For example, Inland Revenue's highly successful IT infrastructure and applications outsourcing focused primarily on making costs both lower and more predictable. And the Defence Procurement Agency has made good use of private finance initiatives to enable the government to buy services instead of owning assets. Its objective? To manage demand for services by making costs visible.

Some countries with a highly decentralized governance structure, such as Germany, for example, may appear less outsourcing mature than they would have if we had taken regional- and local-level initiatives into account. Finally, some countries that might be considered less experienced hold examples of truly advanced outsourcing capability. For a synopsis of the state of outsourcing in each of the countries we surveyed, see Exhibit 1 on pages 16–19.

No matter what the ultimate outsourcing objectives were, a number of leading practices came to the forefront in our research that we believe will help public-sector executives improve their ability to achieve excellent outcomes. While some of these practices are more applicable in some cases than in others, all of them illustrate excellent management approaches that can lead to greater outsourcing effectiveness. We detail these leading practices in the next section, "Leading Practices in Government Outsourcing."

Many traditional outsourcing initiatives had no intention of driving significant change, but have met their efficiency objectives remarkably well.



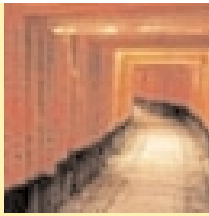
Outsourcing maturity: the global picture

Exhibit 1. An overview of the major outsourcing characteristics of the 23 governments surveyed for this report.

Country	Notes
Australia	Having outsourced a broad range of services of varying complexity since the early 1980s, Australia has gained tremendous experience in many aspects of outsourcing. However, the central government recently undertook a radical change in the way it approaches IT infrastructure outsourcing that might shift its trajectory. Previously, the government mandated a "whole of government" approach, with government agencies grouped together in clusters in an effort to create economies of scale. The expected benefits did not materialize; the enforced outsourcing met resistance from individual agencies, the clusters were unwieldy, and the expected economies of scale were lost to unexpected costs related to managing the arrangement's complexity. Now the central government is pulling back to implement what it calls "second generation outsourcing." Fallout from this initial experience and new levels of autonomy in IT outsourcing decisions may slow the central government's progress toward more extensive use of outsourcing.
Brazil	Most existing IT outsourcing deals are relatively low-level applications management projects, although recent trends indicate the development of more complex outsourcing engagements and practices. While government agencies' outsourcing decisions are made on a highly decentralized basis, general bidding law addresses all phases of the process and provides established and centralized oversight for contract management. Despite a trend toward increased privatization, state-owned enterprises still play a significant role in Brazil's government outsourcing. For example, SERPRO, one of the central government's shared IT organizations, handles substantially all of the government's IT needs, but, in turn, outsources work to the private sector.
Brunei	A newcomer to outsourcing, the government of Brunei is gaining some initial outsourcing experience through a 50/50 joint venture with a private-sector IT provider established in 2001. With the government employing almost half of Brunei's labor force, and recent caps on more hiring, one key driver for the government's outsourcing effort is to create more jobs in the private sector. Fallout from the Asian financial crisis of 1997, as well as the 2000 collapse of Amedeo, the country's premier non-oil company, has resulted in Brunei setting its business development sights high, but also taking an extremely methodical and cautious approach to outsourcing arrangements.
Canada	Centralized guidance, support and standards for outsourcing deals are provided through Public Works and Government Services Canada (PWGSC). A public-sector electronic tendering service—MERX—provides all firms in the private sector equal access to contracting opportunities in the Canadian government. In 1992, PWGSC launched the Common Purpose Procurement initiative to streamline and shorten the procurement process. While, in practice, the tendering cycle time remains the same as before, this policy gives agency executives more latitude to explore innovative approaches before going to tender.
China	Public procurement is mainly handled at the local level, and data about individual IT outsourcing deals are fragmented. The few national-level deals that exist fall into the category of IT purchases, rather than true outsourcing. While China's outsourcing is just emerging, the government professes an encouraging attitude toward it, driven by goals of increasing foreign direct investment, meeting new international standards and promoting treasury reforms.
Finland	The primary IT outsourcing goal is to gain access to technical skills needed to respond to the government's growth. Finland's approach to outsourcing is a wholly decentralized one, with only general guidance from the Ministry of Finance and normal European Union (EU) guidelines. Although the government has a long history of outsourcing, it has contracted relatively few outsourcing deals, and those that exist are not very complex—primarily infrastructure and applications management with a few business process outsourcing arrangements. Radical changes in the way the country sources are not planned, and cost and service levels will remain its key internal objectives.

Country	Notes
France	Development of IT outsourcing in France is significantly hindered by government regulations. By law, contracts cannot last more than three years and deferred payment is prohibited. These restrictions foster an environment characterized by short-term, ad hoc approaches to outsourcing. In addition, strong unions make it difficult to transfer government functions to the private sector. This environment may be changing, however, as a new government working group is considering changes to legislation to accommodate new deal shapes.
Germany	Government IT outsourcing is well developed in Germany at the state and local levels. Outsourcing in the central government is an emerging market, with the economic outlook and associated budget implications fueling the early stages of an investigation into potentially transformational outsourcing engagements.
Hong Kong	IT outsourcing in Hong Kong is effective and well developed. Projects are managed with strict discipline, universally employing the PRINCE ² methodology. A central IT department, the Information Technology Services Department, provides IT services to other government agencies, but because of a lack of internal resources, it relies heavily on private-sector outsourcers to provide these IT services. One noteworthy goal of outsourcing is to fulfill a mandate to stimulate economic development of the local IT economy, which necessitates extensive subcontracting to local companies.
Ireland	The government of Ireland has moderate experience with IT outsourcing and is well recognized in the EU for having substantial online availability of public services, due in large part to effective use of outsourcing. Ireland has one of the strongest budget positions in the world; consequently, the chief motivation for private-sector contracting is not to reduce costs but rather to gain access to technical expertise. IT outsourcing predominantly falls into applications and infrastructure, but a trend toward more business process outsourcing is evident.
Italy	Today, Italian government officials estimate that approximately 90 percent of all central government outsourcing contracts go toward information technology. The current focus on IT outsourcing has had a limiting effect on the breadth of Italy's outsourcing experience. Complex deals, such as business process outsourcing, remain an area of great opportunity for the Italian government if workforce barriers can be surmounted. The government actively encourages outsourcing and expects to do more outsourcing over the next five years. Outsourcing is decentralized, although a central government informatics agency, AIPA, vets contracts undertaken by administrations. The trends are toward using consortia and subdividing contracts to limit exposure to any single company.
Japan	Despite an effort dating back to the 1960s to develop and keep its IT skills in-house, there is currently a trend toward increased IT outsourcing—specifically whole-system outsourcing—in the Japanese government. Strong financial pressures resulting from record budget deficits, an emphasis on streamlining the Japanese government from 23 ministries to 12, and the IT-focused “Japan Revitalization Plan” first developed in 2000 are the main drivers behind Japan's outsourcing evolution. The aim is not only to increase the total level of outsourcing, but also to include more foreign firms in outsourcing deals. A central government initiative, with the direct involvement at the top by the prime minister and his cabinet, further testifies to the government's commitment to outsourcing.
Malaysia	A number of ministries in the Malaysian government are in the process of investigating IT outsourcing opportunities, but in general they have not yet reached the tendering stage. The few projects that currently do exist are in the infrastructure and applications management arena. Every government procurement must go through the Ministry of Finance, which provides direction for project management as well as monitoring of implementation and progress. It effectively has veto power over outsourcing decisions.


² PRINCE (PProjects IN Controlled Environments) is a structured method for effective project management. It is a de facto standard used extensively by the UK government and is widely recognized and used in the private sector, both in the UK and internationally. PRINCE, the method, is in the public domain, offering non-proprietary best-practice guidance on project management. PRINCE® is, however, a registered trademark of the United Kingdom's Office of Government Commerce (OGC).



Outsourcing maturity: the global picture

Country	Notes
Mexico	Outsourcing in Mexico is heavily decentralized, but the law provides a central framework for contracting external services. The IT outsourcing deals that do exist at the national level encompass a range of areas—infrastructure, applications management and some business process outsourcing. The government of Mexico has been slow to take advantage of technological advances, and although there is an effort to improve government transparency, the corresponding culture change has been slow to gain traction. Even though relatively inexperienced, some government agencies are beginning to experiment with transformational outsourcing.
The Netherlands	Despite a shift toward a more conservative government, public opinion is that the Dutch government is becoming increasingly inefficient, and thus IT sourcing remains on the political agenda. However, a risk-averse culture among civil servants, as well as a micromanaging approach toward contracting, precludes the government from embarking on visionary outsourcing projects. A trend is evident, though. Most examples of IT outsourcing in the Dutch government focus on infrastructure and applications management. Unprecedented budgetary restrictions have made cost reduction one of the top motivators behind outsourcing.
Norway	Norway is in the slow lane of the outsourcing evolution highway, moving gradually toward an increasingly decentralized model of contracting with limited central oversight. The government does not actively promote IT outsourcing through its policies and takes a neutral stance when it comes to increasing the level of outsourcing conducted. Norway is not experiencing the budget pressures that are common to many other governments, and consequently it lacks one of the main drivers of outsourcing—reducing the cost of government services. Gaining access to expertise is more commonly cited as a main objective. Most government outsourcing projects fall into the categories of infrastructure and applications management.
Portugal	Most government outsourcing in Portugal occurs within the IT and systems management area, involving small-scale, ad hoc projects implemented by departments to provide specific services. The primary driver is to gain access to new expertise, and there is an overall positive attitude toward outsourcing. Financial pressure also plays a role, but negatively. With a total freeze on all unnecessary expenditures, the pre-planning initiatives required with outsourcing have taken it off the current political agenda. Another barrier to outsourcing is strong union opposition to the practice.
Singapore	IT outsourcing is very important to the government of Singapore. It is well developed and spread evenly across infrastructure and applications. Currently, there is little outsourcing of business processes, but the government plans to contract more functions to the private sector in the future. One of the main goals of outsourcing in Singapore is to improve government officials' focus on core functions.
South Africa	IT outsourcing in the government of South Africa is currently focused on applications—specifically financial systems and Internet portals. Although moderately experienced in outsourcing practices, with projects going back to the mid-1980s, South Africa has only recently implemented a structured approach. In 2000, the Public-Private Partnership Unit was established, which effectively oversees all provincial and national outsourcing deals. Despite this centralized oversight and policy management, outsourcing in South Africa is largely decentralized, with each department responsible for handling its own deals.
South Korea	Privatization has emerged as the most effective solution to the government's fiscal shortfalls, and the concept of outsourcing continues to be promoted as well. Nevertheless, there are currently few examples of true outsourcing being undertaken by the government, although there is some centralized guidance already in place for future outsourcing in the Ministry of Planning and Budget.

Country	Notes
Spain	Spain is making slow, steady progress toward more efficient IT outsourcing. It follows a decentralized model of outsourcing with authorization from a central authority, the CIABSI. Although the bulk of outsourcing contracts in Spain occur at the regional level, the federal government holds the largest contracts, with increased access to technical skills as the primary driver. The government encourages outsourcing, and it expects that it will do more in the future. Major resistance to outsourcing stems from the high unemployment rate, currently the highest in the EU, causing many public-sector employees to fear losing their jobs to private-sector contractors.
United Kingdom	By successfully undertaking complex and visionary IT outsourcing deals, the United Kingdom has established itself as the world's preeminent outsourcing government. Its accomplishments in this arena are well recognized by government executives with outsourcing experience in countries around the world. The primary driver for outsourcing is value for money, which provides a richer set of criteria for judging effectiveness than reduced costs or increased expertise alone. The National Audit Office is explicitly charged with evaluating value for money in significant outsourcing deals, while the Office of Government Commerce plays a catalyst role in helping individual agencies achieve this objective.
United States	IT outsourcing projects in the US government are heavily focused on technology infrastructure at this time. The government has a positive attitude toward outsourcing, driven in large part by mandates from senior executives—starting with the president—to improve efficiency, reduce government costs and increase quality of goods and services produced. Outsourcing policy is substantially decentralized. Multiple government agencies, such as the General Services Administration and the Office of Management and Budget (OMB), provide oversight, but individual departments are on their own when it comes to outsourcing decisions. Even central oversight is limited, as policy is created and passed down but generally left up to individual departments to interpret and implement—or not implement—as desired. OMB Circular A-76 provides guidelines on when activities should be performed under contract with commercial sources or in-house with government facilities and personnel.



Leading practices in government outsourcing

As we examined the global landscape of government outsourcing, we discovered that different countries exhibited different strengths. In many cases, several countries' success to date hinged upon their ability to manage one or more elements of an outsourcing initiative particularly well.

We have crystallized these leading practices, categorizing them according to the six areas of outsourcing in which effective management is critical for success:

- Shaping the relationship to the situation
- Negotiating and contracting effectively
- Managing workforce issues
- Managing the ongoing relationship
- Ensuring strong performance
- Institutionalizing flexibility and innovation

Whether the end goal of outsourcing is greater efficiency in existing processes or true agency transformation, governments will be more likely to achieve their objectives if they adopt practices that have proven successful. These practices must, however, be tailored to the government's primary purposes for outsourcing.

Shaping the relationship to the situation

Effective outsourcing starts by establishing clear strategies and goals to guide an agency's efforts. Before embarking on any outsourcing project, government agencies must take the pulse of their constituents and stakeholders, take the measure of their internal support and address the threats and opportunities they face. Then they must clearly articulate exactly what they hope to accomplish for their stakeholders. For many governments, outsourcing then becomes part of the executive tool set, and leaders use it to address very specific strategic ends. As such, executives shape the initiative and the relationship that underpins it to meet the agency's specific strategy, situation and needs. Our interviews identified these leading practices related to shaping the outsourcing relationship to the situation:

Provide central guidance, but leave accountability with agency executives.

Our research showed that outsourcing is more likely to be effective when it is motivated by a strong business case and supported at the agency level.

Top-down mandates from central authorities breed lack of enthusiasm at best and resentment at worst. Australia's cluster approach moved forward despite the intense opposition of leading stakeholders, only to be derailed a few years later as the affected agencies failed to achieve the expected benefits. Government agencies can take advantage of central experience and guidance during the negotiation process, but inflexible rules from a central authority that is distant from individual agency situations can cause significant challenges for the executives expected to implement them.

On the other hand, complete decentralization with no central guidance can leave agencies foundering. Governments that have developed processes for sharing knowledge and practical lessons improve their overall capabilities at a faster pace. In addition, policy guidelines and central outsourcing parameters can give inexperienced agencies a solid initial platform from which to build. Rather than either extreme, agencies and cooperating groups of agencies should be accountable for their own outsourcing decisions, which should be made within a results-oriented regulatory framework with guidance from a central policy.

Drive outsourcing decisions through strategy.

A clear statement of the agency's goals and objectives can make the outsourcing decision far simpler. An agency should start with its vision and then ask how to make it happen. As a result, it may choose to use outsourcing to bring in specialized skills or to improve the speed at which new services can be delivered. In Hong Kong, for example, the Information Technology Services Department (ITSD) developed its government services portal from scratch and in a very aggressive time frame through outsourcing. The driver? The governor's ambitious aim to make Hong Kong the information hub of the world by delivering all government services to the public electronically. Faced with the need to build a totally new infrastructure and to provide the applications within one year, ITSD turned to outsourcing.

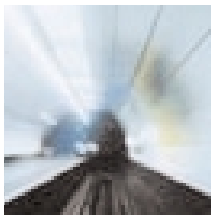
An agency's overarching goals and objectives will direct its outsourcing efforts and provide the measures of its success. Therefore, it must clearly define these goals and objectives before the tendering process even begins. Once people inside the organization understand them, they can more easily

articulate clear goals to the provider. It is then up to the provider to show how it will help achieve them. For example, a government seeking to use outsourcing as a way to develop local industry may specify that the winning vendor include smaller, local players as part of its outsourcing solution.

An outsourcing supplier, no matter how deep its resources, should not be given the responsibility to set the strategic direction for a government organization. That is clearly the domain of public-sector management. However, executives can call on the outsourcer to help map out the actions that will achieve the objectives set by its leaders. Collaboration on strategy becomes increasingly important as an agency moves from outsourcing infrastructure toward outsourcing entire processes. Keeping outsourced agency processes aligned with strategy requires more intense collaboration than ensuring an outsourced IT infrastructure supports long-term plans.

Explore options and learn from others before going to tender.

Before setting their requirements in stone through a formal request for proposals (RFP), many successful government agencies made good use of an intense period of information gathering to lay the groundwork for their initiatives. This exploratory process allowed them to solicit ideas, investigate innovative approaches and test the private sector's appetite for different models. For example, rather than provide a detailed tender specification to start, National Savings and Investments in the United Kingdom issued an Information Memorandum to a group of four qualified, multinational outsourcers. According to Steve Owen, Partnerships and Operations Director, "We realized we had a lot to learn, so we didn't issue a formal tender. We described our business, our challenges and constraints, and invited outsourcing providers to come back to us with creative solutions. It was a deliberate attempt to draw in information and ideas." Azhar Hj Ahmad, System Analyst in Brunei's Ministry of Finance, describes his view of his country's approach this way: "Even though Singapore and Australia may have their own ways, we would prefer to learn from their and others' experiences before we proceed. We may be a bit cautious and careful in our approach, given the maturity of outsourcing services in Brunei."



Leading practices in government outsourcing

This information-gathering stage helps an organization craft the highest value outsourcing initiative. Governments that have procurement policies that restrict this open information-gathering stage, and the generative time to make sense of the conclusions, will find themselves able to do only simpler initiatives with lower potential value. Spending the time to gather information up front is a valuable investment. By becoming more educated on the possibilities and more sure of their goals, agencies may find that the other procurement stages take less time. More importantly, however, agency executives expand their understanding of the opportunities for creating value.

Design a business model, not a deal.

The best outsourcing initiatives are those that create value for both sides. This means designing a joint operating model that allows the private-sector firm to make a reasonable profit as it generates benefits for the public sector. Leaders use the pre-contract stage to explore innovative models with private-sector parties. For example, as part of its portal project, the Hong Kong government works with private firms in a way that pays for the ongoing maintenance of the portal. To provide a one-stop service for citizens, both government departments and related commercial vendors offer their services and transact business with citizens directly through the portal. That means a couple applying for their marriage license online could also book a photographer and order flowers for their wedding at the same time. Vendors pay a fee to have access to this convenient channel, and these fees cover the entire cost of maintaining the portal. The Hong Kong government, which has control over the commercial content on the portal, avoids the cost of maintenance and is able to offer improved service to citizens.

This particular innovative model will not be right for every situation, but it represents a conceptual approach that is. Executives should deconstruct their own sources of value and investigate the business models of their private-sector partners. This analysis positions government executives to explore new ways of working with private firms to make the most of what they can jointly offer.

Negotiating and contracting effectively

Managing *strictly* by the contract is a formula for disaster in outsourcing, but experienced public-sector executives use the process of negotiating the contract to set the tone for the entire relationship with their outsourcing partner. Our interviews yielded the following insights into leading practices in negotiating and contracting effectively:

Take ownership of the negotiation process.

Government agencies sometimes delegate the time-consuming task of negotiating an outsourcing contract to specialists. Whether these are internal contracting officers or external experts, this is the wrong approach. Although contracting specialists can provide useful advice, their incentives often lead them toward adversarial approaches and a focus on cost reduction to the exclusion of other objectives. The outsourcing relationship that results may bear no resemblance to the collaborative partnership that agency executives need to succeed. Effective outsourcing leaders take advice from specialists, but own the negotiating process personally. That way, they can ensure that the objectives and principles that are central to their agenda are also central to the contract and guide the relationship with their provider.

Include values and principles in the contract.

The contract should contain not only specifics about service level agreements and system capabilities, but also guiding principles for the relationship as a whole. One senior official in the UK government's Department of Trade and Industry routinely includes partnership principles in that department's contracts. "It acts as a constant reminder to us of the way both parties were expected to work together when the contract was first signed," he says. These relationship principles are not legally binding, but they represent a very public commitment by both organizations to work together and to ensure each other's success.

Use stakeholder analysis for key decisions.

Crafting an effective outsourcing initiative involves several critical decisions. Executives must decide whether to outsource to a single provider or to coordinate a series of smaller contracts. Furthermore, they must choose the right partner or partners. Leading organizations use stakeholder analysis to guide them

in these important choices. They first identify the key stakeholder groups. Then they develop a detailed description of the needs of each group. By assessing each option against these needs, executives can reach a decision that is best for all of the key constituencies. For example, the executives at National Savings and Investments used this process both to choose the right outsourcing approach and to select the best partner. Steve Owen explains, "Our decision process was built around four stakeholders: the staff, the Treasury (our owners, if you like), the customer and ourselves as a strategic business. We defined just what each stakeholder would be looking for and assessed each option against their needs, in detail. That drove us down the route to a single provider."

Plan for the future during the contracting process.

During our in-depth interviews, executives frequently asserted that they placed so much attention on getting an outsourcing deal off the ground that they gave little thought to how both partners might need to change what they are doing in the future. As a consequence, many initiatives start off strong, but falter after a few years as changing requirements stress the relationship. Rear Admiral Charles Munns, director of the US Navy-Marine Corps Intranet (NMCI), reflects upon his personal experience: "Looking backward, and I wasn't there at the time, the Navy people in that period did a wonderful job of putting the contract in place and creating a partnership with the team here. The piece we missed was the hard work our own department had to do as this went forward. The sense was that we put the contract in place, now we would just sit back and wait for services to be delivered. It's obvious now, with the size and complexity of the department, there's a lot of work we have to do to get ready, make introductions and to change the culture to make sure that once the service is delivered it can be successful, adopted and used. That's what my team is doing now."

Every contract addresses termination, but leaders should take two additional steps. First, they should build a framework for change management into the governance process. They should outline a systematic mechanism for dealing with change, ensuring that it is flexible enough to cope with new regulations and shifts in the business environment. They should not attempt to specify every change that might occur, but focus, instead, on the process for dealing with it.

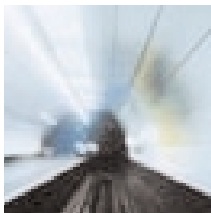
Effective change management mechanisms include ways of dealing with conflicts that may arise from changes in expectations over time.

The second step leaders should take is to incorporate long-range planning into the contracting process itself. Many outsourcing projects fall short by neglecting to ask what the future of the organization might be and what the organization should do to lay the groundwork for that future. Many executives we spoke with made the mistake of thinking that a process would take care of them. According to one senior official in the Australian government: "That issue [of future agency planning] was not a driving issue. It might have been there at a high level—the thinking that if you outsource this to experts, you will gain in the longer term. But on the ground, we paid it little mind."

We are not just recommending that the contract include provisions for a joint planning process. That is obvious. Partners should also participate in joint planning *as they craft the contract*. The outcome will be provisions in the contract and the relationship for some of the critical risks and opportunities the partners foresee.

Through a structured scenario planning process, the partners can explore the factors that will influence their options in the future. By assessing a range of potential scenarios, they can make some current decisions about long-term investments. They can take a position on how growth will be handled and how technology changes will be incorporated. They can even make provisions to deal with regulatory change that affects the outsourced service.

Lasting relationships build in contingency plans for expanding or contracting scope and the associated time for readjustment. Finally, the partners can establish procedures that enable disengagement, should conditions change so much that it becomes better to dissolve the relationship. While it is impossible to predict exactly what shape the future will take, the partners can use scenario planning to give their initiative more resilience and agility.



Leading practices in government outsourcing

Managing workforce issues

Our research showed that managing workforce issues effectively is a hallmark of outsourcing maturity. Mastering the ability to transfer workers from the public to the private sector is also characteristic of countries on the transformational trajectory. Not surprisingly, we saw few examples of effectively managed workforce transitions. In fact, 75 percent of our survey respondents reported that they transferred no government workers to the provider as part of their outsourcing. In some countries, the cultural attitudes around public-sector employment meant that outsourcing programs stopped short of transferring workers. These attitudes limited the potential uses of outsourcing. Still, some government organizations have learned how to manage this difficult activity effectively. The resounding themes from their successes around workforce management include:

Recognize that workforce management issues are not insurmountable—they just take work.

The executives we interviewed who had transferred workers all told a common story—that there is no mystery in handling labor and union issues in outsourcing, but it does take careful attention and hard work. Their advice? Involve union representatives early and often. Identify the sticking points—fears of job loss, loss of pensions and other benefits—and map out a strategy for dealing with each one. Then communicate aggressively.

Adjust workforce solutions to your situation.

One answer is not right for every workforce situation. Some executives we spoke with worked out a number of different placement alternatives for their employees, dealing with each major category of employee (long term versus short term, for example) and offering appropriately tailored options for each group. They approached the issues category by category, until every one had been resolved. In a number of countries, including the United States, the human capital crisis makes this process easier, not harder. With record numbers of impending retirements in many government workforces, the number of job openings in the government ranks may run well ahead of candidates freed up by outsourcing.

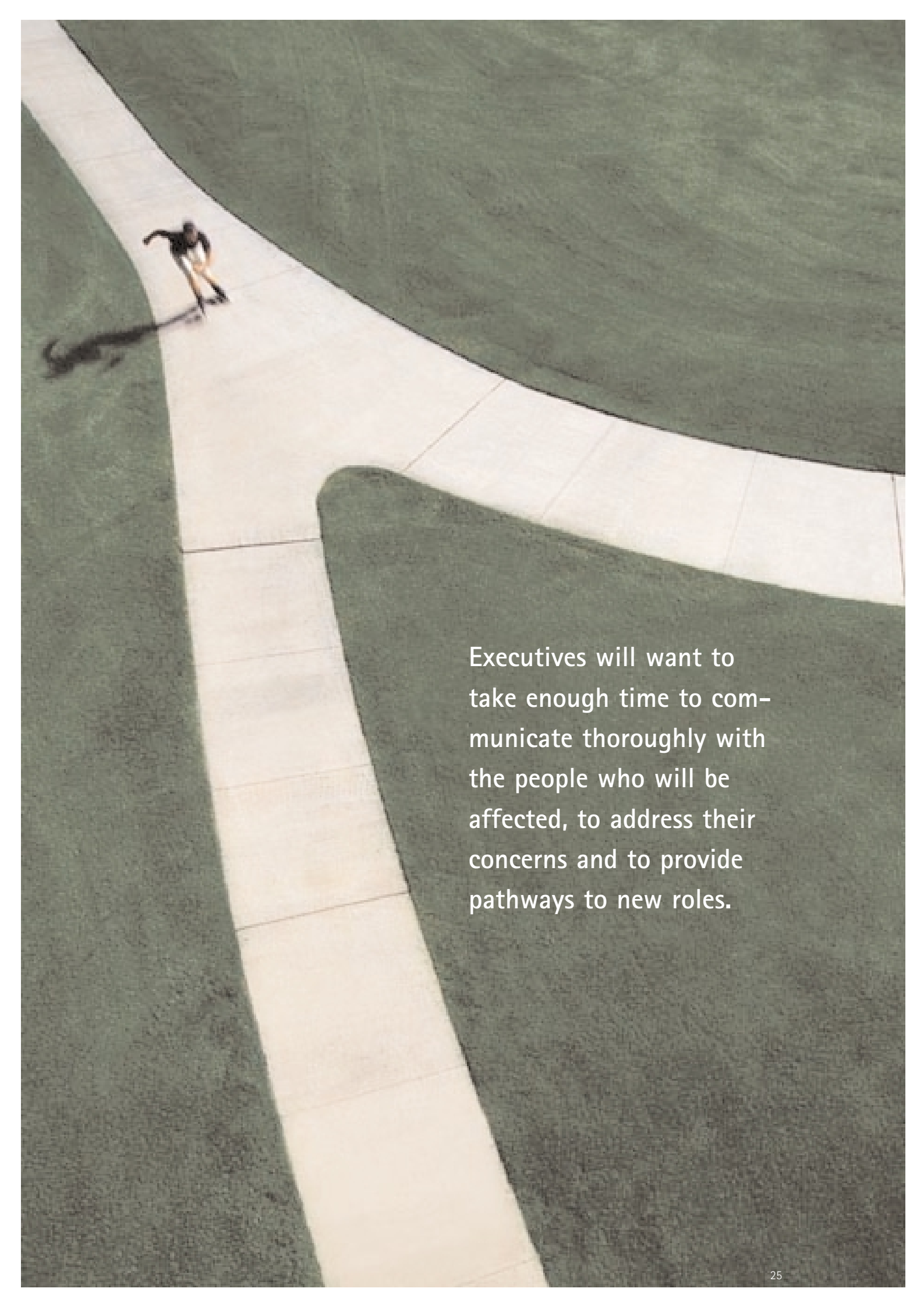
In some cases, Australia's "clean-break" model was the best approach. In this model, the government doesn't engage in negotiations with providers over the staff. On Friday, they are terminated as government employees and given substantial redundancy payments; on Monday, they can be hired back to work by the outsourced company. This approach greatly simplifies things for the government agency and may be quite attractive to the employees if the economy is vibrant and their skills are in demand.

Set a prudent pace for dealing with workforce transitions.

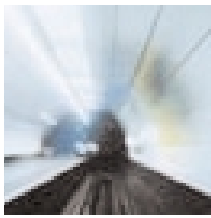
No matter how you look at it, workforce transitions are disruptive. Executives will want to take enough time to communicate thoroughly with the people who will be affected, to address their concerns and to provide pathways to new roles. Understand, however, that stretching out a painful process does not serve anyone well. The longer the process takes, the more likely it is that the most skilled workers will seek jobs elsewhere. This drains the government's knowledge capital as well as threatens its ability to transfer its work effectively to its outsourcing partner. Executives should spend time on planning the transfer and on training afterwards, but should not unnecessarily protract a painful process. One veteran outsourcing executive explains, "Time is the enemy. You must go fast. If you go slowly, the people who are against you have more time to get organized. It took us less than a year from RFP to contract. You should shoot for a year."

Managing the ongoing relationship

Establishing and sustaining a commitment to deliver high-value outcomes through outsourcing means government executives must go beyond contract management to master relationship management. It requires leadership at the highest levels of both



Executives will want to take enough time to communicate thoroughly with the people who will be affected, to address their concerns and to provide pathways to new roles.



Leading practices in government outsourcing

public- and private-sector organizations and fresh thinking about how to deliver outstanding results for both parties. These leading relationship management practices include:

Open the books on both sides.

Sharing information about cost structures can be a powerful way to cement trust in the relationship. In cases where we saw this happen, it provided a solid foundation for resolving disputes and embracing change. It led to a strong sense of partnership and “in it together” teamwork. Don Brown of the UK Inland Revenue recommended this approach to his provider to try to heal a troubled relationship. Both sides now see it as a turning point in their relationship.

Openness on the part of the vendor also allows the government agency to evaluate claims that the provider is not making an adequate profit. One official from Australia’s Department of Health and Ageing describes the experience his agency had when its outsourcer began applying pressure to negotiate a higher contractual payment: “We assume they enter these contracts in good faith. We have fiduciary responsibility. Having said that, we’ve shown a willingness to renegotiate where they can show a loss. But...they are not willing to expose their books and reveal their cost structure, so it’s only their assertion about losses.”

Leverage procedures appropriately to address sensitive issues.

Clearly establishing a governance structure that defines important methodologies and escalation procedures can introduce both distance and guidance when issues arise. For example, most organizations spell out a regular series of governance meetings in their contracts, but in some cases they quickly lose interest in attending. Experienced outsourcing executives, in contrast, rely on these structured sessions to ensure that important issues get a ready hearing. These executives aim for enough methodology to put rigor in important processes and enough flexibility to adjust to the pressing needs of the situation.

Disengagement is one process to which leaders pay particular attention. This may happen through termination at the end of the contract, termination through right, termination through breach or termination through changing circumstance. Leading executives audit disengagement documentation on a regular basis throughout the contract. For example, they assess whether the outsourcing provider has up-to-date descriptions of system and process flows, comprehensive data definitions for critical information files and a complete set of job descriptions for the operating organization. Further, they formalize this process through the service level agreement with the vendor. Overlooking this critical discipline can result in what one executive describes as a “straitjacket” relationship—with partners unable to perform and clients unable to disengage. As one experienced executive says, “The last thing a vendor wants to provide is a mechanism for the client to extricate itself from the contract, which means the documentation you’ll need to go back to the market.”

Maintain a “whole of business” perspective.

Outsourcing relationships founder when the parties draw crisp boundaries around their separate responsibilities and then stay in their own terrain. Successful government agencies actively help their providers succeed, even when it isn’t their responsibility. For example, the structure of the relationship at National Savings and Investments (NS&I) means that its partner bears the financial consequences if NS&I marketers design a savings or investment product that is very expensive to operate. In consideration of that fact, NS&I executives work hard to consider the operational implications before finalizing new product features.

Focusing on price to the exclusion of other considerations may not create the results executives need. Glenn Pure, the Group Five (outsourcing cluster) contract manager from Australia, advises, “If the price looks too low, don’t believe it. And if you sign up to it, you can be sure you will have trouble later unless you can be convinced by the outsourcer that they can provide it and make a profit.” If you cannot satisfy yourself that your provider will earn a fair profit by working with you, you have not created a viable outsourcing initiative. It cannot last.

In line with our recommendation on page 22 to craft a business model, not a deal, it is imperative that outsourcing leaders create arrangements that both sides can sustain over time. The good deal a government negotiates for itself needs to be a viable one for the outsourcer as well. It is important for all parties to recognize that the relationship will work only if there is mutual benefit. This carries with it a commitment to evolve the relationship over time, ensuring the value proposition remains flexible enough to maintain mutual attractiveness and benefit.

Use conflict as an opportunity to improve the relationship.

Relationships are never linear; they progress through a series of peaks and troughs. These include occasions of accomplishment and resulting accord. As often, however, they involve points of conflict and tension. Kevin Browne, Libra Contract Manager for the Lord Chancellor's Department, describes the path of his agency's relationship with its outsourcer this way: "It was up and down. It was cyclical. There were times when huge cooperation and trust existed, and other times when deviations from what we had agreed made us less trusting and cooperative."

In times of tension over expectations and service levels, excellent leaders resist the temptation to adopt an adversarial attitude. Uncooperative approaches are likely to lead to an impasse that serves neither party's interests. In the words of one executive, "When things get rough, it's normal to step back into a confrontational mode. It takes guts and personal leadership to keep the faith in terms of 'we will succeed together or fail together.'"

The United Kingdom's Browne faced a situation in which some may have regarded the contractor as being in technical breach of the contract, "but the cost of litigation would have set us back even further." He shares his department's approach: "Meeting our deadlines was quite imperative, and we were fairly constrained on price. But we were always consistent about our principle—we focused on what the contract meant, rather than just what it said. We believed that the contract was intended to

represent what the parties *wanted* to do, so we did not allow it to dictate what people *had* to do."

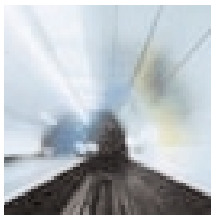
Conflicts can start a relationship on a fast downward slide if partners yield to a natural tendency to retreat to their corners. Executives who find ways to arrive at a mutually acceptable resolution can foster long-term trust instead. Successful leaders recognize and harness the potential in conflict points by approaching them as opportunities for growth.

Ensuring strong performance

The starting point for ensuring strong performance in an outsourcing project is to aim for outcomes, and then work with your partner to craft clear, achievable plans to reach them. For most executives, the starting point is the service level agreement (SLA). Well-crafted SLAs are a powerful base when they include both quantitative and qualitative performance measures and are tailored to the specific initiative. Our research pointed out these additional leading practices in ensuring strong performance:

Maintain critical expertise.

Management oversight of the outsourced function cannot be delegated to the provider. If the government agency is to remain accountable for a function, it must maintain the critical expertise to understand how that function should operate. For example, when the Australian government outsourced its Group Five IT infrastructure, one executive recalled: "We declined to be victims of our provider's global process. Most of their processes were designed to avoid risk for themselves, not to provide benefit for us. We spent lots of time and contractual leverage to ensure we had a strong say about how our processes would work." This was possible because Group Five had the management and technical expertise to stand their ground.



Leading practices in government outsourcing

Tap proven methodologies.

All of the executives we spoke with in Hong Kong, which we found to be highly mature on the efficiency trajectory, spoke of the PRINCE (PRojects IN Controlled Environments) methodology as the engine behind their successful technology infrastructure and applications outsourcing. Frank Lai, chief systems manager for the Hong Kong Information Technology Services Department, claims, "We define each stage clearly, and we know what the deliverable is. PRINCE allows us to monitor each stage of the project completely. It also prescribes specific meetings to monitor projects. That's why we can keep projects under control even when a large number of parties are involved."

Track qualitative performance indicators as well as quantitative ones.

Every capable outsourcing manager watches operational performance through service level metrics. The most sophisticated ask the provider to self-assess performance and to offer improvement plans for any lapses. Leaders also include qualitative performance tracking on their agenda, most frequently as part of a comprehensive scorecard. Often the provider earns bonuses by exceeding performance targets. Operating executives meet on a regular basis with their providers specifically to discuss the state of the relationship and to agree upon any actions they will take if performance appears to have gone off course. For example, one organization includes performance measures for cultural fit along with more conventional service level assessments. The annual cultural-fit survey asks the provider's internal customers pointed questions like, "How well do they listen?"

Another important qualitative assessment addresses the balance of influence and control in the relationship. The sustainability of an outsourcing initiative relies on keeping a balance over the long term. However, at any one time, one partner is likely to have an advantage over the other. And shifts in influence are inevitable. For example, during the negotiating process, the agency holds greater leverage because it has the contract to let. After the contract is signed, the balance shifts in the other

direction because the agency is dependent on the provider to deliver key benefits. Further, the factors that contribute to a healthy balance can reach well beyond the organizations involved. For instance, the provider's other business prospects can make the current initiative look very poor or very good in comparison. When the government of Australia publicly revoked its mandate to outsource all IT infrastructure, it instantly removed the promise of additional business for the current providers. Their perception of future profits from the relationships dropped deeply as a result.

Leaders keep an eye on the balance of influence to make sure it stays on a relatively even keel. When big changes or slow erosive forces throw it off kilter, executives step in to contain the damage. For example, the executives at National Savings and Investments are keeping a close watch on their provider's profits on the arrangement to make sure the relationship remains financially attractive to it.

Institutionalizing flexibility and innovation

Achieving high-level outcomes in a changing environment requires institutionalizing innovation as part of the outsourcing process. We have already argued for joint strategic planning, starting during the contracting process. Government agencies at the far end of the transformational trajectory stimulate new ideas and drive innovation through these additional leading practices:

Make your innovation plans explicit.

Executives should verbalize their expectations for innovation and quantify how they will know when they are achieving them. Leaders hold regular innovation reviews both to assess their progress and to spur new thoughts. To institutionalize innovation in an outsourcing relationship, executives need a method, not a promise. Most public-sector outsourcing relationships rank poorly on this scale. The UK's Inland Revenue is a notable exception. That organization programmatically invests in system

improvements. The investment funds specifically earmarked for this purpose are established contractually. In an example from the private sector, one firm schedules its provider to present innovative suggestions to its board every quarter. This not only obligates the outsourcing provider to spend quality time on developing new ideas, it obligates the board to make the time to hear them. This approach could easily be applied in the public sector as well.


Remain externally focused.

Many government executives we interviewed took regular field trips to other government operations to share insights and practices. They also welcomed visitors from abroad in the same spirit. In fact, some of the countries that were less experienced in outsourcing, but on the fast track, stood out in this regard. For example, government executives in

Brunei, in their effort to establish their first 50/50 joint venture with a private-sector firm, conducted extensive conversations with officials in a number of other Asia Pacific countries to refine their approach.

Tap the resources of a multinational corporation.

Many government agencies contract with large, multinational corporations as their providers. This enables them to tap into the broader resources of these organizations. To take advantage of this opportunity, executives ask the outsourcing provider what it can bring to the table beyond just technology—in areas such as marketing, research, and extended relationships and alliances. For example, one provider routinely gives briefings to government executives on its latest research in management issues.



Achieving high-level
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Transformation in action: National Savings and Investments

Background

Peter Bareau, an experienced banking leader from Lloyds, took over as Chief Executive of National Savings and Investments in July 1996. National Savings, as it was called at the time,³ had recently been changed from a government department to an Executive Agency of the Chancellor of the Exchequer, the UK's Treasury ministry. This shift increased management autonomy and, more importantly, created an opening at the head of the organization for an executive CEO.

The United Kingdom's National Savings and Investments, or NS&I, was originally created in 1861 as a way of promoting savings. In World War I its role expanded, as the government issued National Savings certificates to start raising funds from the public to finance the war. By the mid-1990s, it had two main functions: tap the retail market to promote thrift and help the government raise money.

What Bareau found as he surveyed the agency was somewhat daunting. The staff numbered 4,650 civil servants with an average tenure in the organization of some 20 years. Products and services were supported in three separate operational sites that were not connected in any way. Telephone support was minimal, and the computer systems infrastructure had suffered from lack of investment and was no longer up to date.

³ The agency was named National Savings in 1969. It adopted its current name, National Savings and Investments, in early 2002. For simplicity's sake, we will refer to it as NS&I.

While the organization had a more than £60 billion balance sheet and the largest customer base of any retail financial institution, it also had an unwieldy legacy systems environment and a relatively high cost structure. In the fast-paced financial services industry, NS&I had introduced only three new products in the past eight years. Notes Bareau, "Our image was old. We weren't regarded as being dynamic. The organization was so uncompetitive that the government was questioning whether it should exist at all."

Anatomy of an outsourcing initiative

Bareau's first step was to clarify the organization's mission. He established that one of the traditional aims—to make savings products available to the populace—was well managed by the private sector. If this were the only reason for NS&I to exist, it would be short-lived. The merits of its second aim—to provide a cost-effective source of funding for the national government—hinged on whether or not NS&I actually added value.

During 1996 and 1997, with the help of outside consultants, Bareau and his executive team worked closely with the Treasury to develop a strategy. They looked at a full range of possible futures for the organization. This process established that NS&I could finance national debt at a cost that was lower than Treasury certificates. However, no one in the organization was under any illusions about whether this could continue without substantial investment in organization, systems and infrastructure. Says Bareau, "If we didn't dramatically lower costs, improve products, build a customer database so we could market better, change our image and add professional capabilities, our risk would grow and grow until we had no value left."

Again with the help of private-sector experts, Bareau and his team set a new strategy for the organization with an aspiration not just to survive, but also to leapfrog private-sector competitors in the personal-savings market. A senior member of his team points out the depth of the challenge: "We didn't have the skills; we didn't have the technology; and we had limited capital. It sounds perverse, but we found it difficult to reduce staff numbers at the desired rate because we had limited financing available. To succeed, we needed to transform the business very quickly in a way that was self-supporting. So we looked at the outsourcing model."

Through a unique process, Bareau's small senior team decided that the project would best be done in one comprehensive, radical deal rather than a series of smaller arrangements. Explains Steve Owen, the project manager at the time (now Partnerships and Operations Director), "Our decision process was built around four stakeholders: the staff, the Treasury (our owners, if you like), the customer and ourselves as a strategic business. We defined just what each stakeholder would be looking for and assessed each option against their needs, in detail." That drove the decision toward a single provider to provide the single customer view, integrated systems and investment commitment that NS&I needed for wholesale transformation.

NS&I went through the legally prescribed procurement process and posted a very broad tender offer. From the more than 80 expressions of interest they received, the team qualified four candidates as capable of moving to the next stage of the process. However, they

Leading practice in action:

Drive outsourcing decisions through strategy.



Transformation in action: National Savings and Investments

still had not determined exactly where to draw the boundaries between what would be outsourced and what would not.

Leading practice in action:

**Explore options and
learn from others before
going to tender.**

Rather than provide a detailed tender specification at that point, NS&I chose an innovative approach that still met the requirements of the European procurement regulations, and issued an Information Memorandum to the four groups. Recalls Owen, "We described our business, our challenges and constraints, and invited [them] to come back to us with creative solutions. It was a deliberate attempt to draw in information and ideas." Between summer 1997 and spring 1998, NS&I talked with potential partners, evaluated proposals and learned.

In April 1998, NS&I invited two multinational firms to negotiate further. The agency issued a formal tender specification that articulated clear requirements, a business model for the partnership and even a draft contract. By this time, the NS&I executives had arrived at a fairly radical conclusion: They would continue owning their stakeholder relationship with the British government, and their product, marketing and channel strategies; everything else could be outsourced.

To keep the competitive process lively and informative, NS&I actually negotiated a full contract with both suppliers. This forced discussions and analysis to an unusual level of detail and ensured that NS&I achieved the best possible terms and conditions.

Leading practice in action:

**Design a business
model, not a deal.**

It was clear from the outset that modernizing NS&I would mean dislocating staff. Owen comments, "We had been getting smaller for a long time. In the 1960s, we had 15,000 staff. By early 1999, we were down to about 4,500." However, the executive team believed that, despite the disruption, a good outsourcing model would provide the best chance for workers to continue employment. NS&I sought a contract that would encourage the provider to win new service accounts that would utilize transferred workers. According to Owen, "If it worked the way we hoped, the provider would have a valuable asset—an operations center with robust infrastructure and trained staff—with which to gain new business. That's how we sold it to our people, the unions and the local politicians in Glasgow, Durham and Blackpool."

Leading practice in action:

**Recognize that workforce
management issues
are not insurmountable—
they just take work.**

The NS&I team started communication with the staff from the beginning of the process. They held "road shows" to address staff fears about pensions, pay and new work expectations. They also allowed the bidders to present to their staff—a total of 53 presentations that were low key, informal and aimed at dispelling fear. Each group session eased some concerns and opened up the next tier of issues. Because the business case for outsourcing was very strong, the NS&I executive team believed that ultimately the staff would recognize the need for change.

The competing bidders both knew that creating new jobs for outsourced NS&I employees would be central to the winning strategy. One framed the NS&I deal as a strategic acquisition: It would acquire 1 million square feet of space and thousands of people that would form the core of an administrative services center outsourcing model. The acquired asset would be used as a shared service facility to deliver to other customers in both the public and private sectors. This showcase deal would be the foundation for it to win other transformational-change contracts. The other bidder, in contrast, claimed that it had the scale to absorb NS&I employees into its organization through normal business processes.





Transformation in action: National Savings and Investments

Leading practice in action:

Tap the resources
of a multinational
corporation.

The NS&I team had some concern about one bidder's level of experience in both business process outsourcing and the banking industry. To mitigate this risk, Bareau and his team established a relationship with its corporate headquarters, which guaranteed the contract.

By the time both providers' contracts were negotiated, the NS&I team had invested a great deal of time to determine exactly what the organization needed. Again aiming for a balanced view, the team based the final decision on a detailed assessment of the needs of the four key stakeholder groups. No matter how the criteria were weighted, one clear answer emerged.

In December 1998, NS&I announced it would award a 10-year contract (total value of £635 million) to its provider, with an option to extend for five additional years. All of NS&I's operations, customer service, technology and transaction processing, along with 4,153 largely unionized civil servants, would be outsourced. NS&I would retain 120 full-time civil servants on the payroll to handle strategy, marketing and product design and to manage the relationship.

Embarking on a new trajectory

As the NS&I team embarked on their modernization, they faced several significant uncertainties. To win the work, the provider had to define the cost of running the operation post-transformation and to start charging at that rate on day one. In addition, it was required to determine service levels for all NS&I activities and hit performance targets to avoid incurring penalty fees (see Figure 8). Up until that point, key performance indicators (KPIs) had not existed.

The provider focused on executing an effective transition process to start the relationship off right. This included clear models for human relations support and counseling as people changed employers. One provider executive states proudly, "By sticking close to the unions, and being open and honest with them early on, we headed off the people issues before they became grounds for serious concern and we maintained positive relations with both staff and unions."

As the provider stepped into the maelstrom of organizational transformation, it faced massive challenges. It considered the technology implementation fairly straightforward; other aspects of the transformation, however, were more problematic. It found that it not only took longer to make staff reductions, but that the operation might ultimately require more staff than had been planned to run it. By the end of 2002, although this was later than planned, the provider had reduced the staff by 50 percent through a combination of redeployment and voluntary release.

During this period, the provider was undergoing a massive transformation of its own. It came to the partnership with obvious strength in technology, but a less solid footing in the banking industry and administrative service management. One NS&I executive comments, "We had to do more work than we expected to help them understand banking. They're also coming up the learning curve on business process outsourcing. But they bring a huge technology capability that we couldn't have tapped into ourselves. Together, we're a great team."

The provider had committed to redeploy 1,200 of the displaced NS&I workers for new accounts. In 2001, it was able to win a large contract from a UK bank for back-office processing services that required a staff of 700. The provider won a profitable deal against stiff competition. It was also able to win an additional piece of work with the UK government in passport contracts. The Passport Agency wanted a seventh regional office, and the provider won with the proposal to build it in an NS&I facility.

Figure 8. Example of key performance indicators used by NS&I and its provider.⁴

Area of coverage	Broad description	Number of KPIs and grading			Date of introduction	Measurement	Frequency of reporting
Treasury management	Banking of receipts and transfer from local banks to Bank of England. Transfer to and from National Loans Fund and National Debt Office	2	3	—	4 at 1/4/99 1 to be decided	Timeliness and accuracy of money movement	Daily
Product delivery—sales	Dispatch of customer documentation, sales queries and updating of records	—	—	5	4 at 1/4/99 1 at 1/10/99	Timeliness of dispatch and response to queries and accuracy in compliance with customer's instructions	Daily or weekly monitoring with results reported monthly
Product delivery—after sales	Replies to queries, dispatch of statements of interest	—	—	7	4 at 1/4/99 2 at 1/7/99 1 at 1/10/99	Timeliness of dispatch Accuracy of replies to customers	Daily monitoring with results reported monthly Quarterly for ISAs Annually
Product delivery—payments	Dispatch of payments and customer documents, queries	—	2	2	3 at 1/4/99 1 at 1/10/99	Timeliness of dispatch and accuracy in compliance with customer's instructions	Daily monitoring with results reported monthly
Product delivery—premium bond prizes	Informing major winners, dispatch of high value claim forms and of prize warrants, and automatic reinvestment of prizes	—	1	4	5 at 1/4/99	Timeliness of dispatch and accuracy	Monthly

■ Platinum ■ Gold ■ Silver

⁴ NS&I did not introduce all of the key performance indicators at the commencement of the contract. Those not introduced immediately were in areas where NS&I had not previously measured performance or were for new processes introduced under the contract—for example, the provision of management information by the private-sector partner to NS&I. The provider wanted to gain experience with these measures before it became subject to performance deductions.



Transformation in action: National Savings and Investments

Whole business thinking makes the relationship work

Leading practice in action:

Leverage procedures
appropriately to address
sensitive issues.

From the outset of the contract, most of Bareau's team recognized that they had not shed management responsibility; they had simply traded one type of management challenge for another. NS&I and its provider executives began to exercise their joint governance process to actively manage the relationship (see Figure 9). This included an annual meeting between the Treasury minister and the head of the provider firm, monthly board meetings that involved the CEOs of both NS&I and the provider, monthly business management meetings, and meetings of seven or eight task-oriented boards as needed.

Leading practice in action:

Maintain a "whole of
business" perspective.

Clear objectives and aligned goals were critical to success, but flexibility was as well. The contract established NS&I's ability to launch a certain number of new products each year for no additional fee to the provider. But the NS&I team learned that they might set back the provider's service level achievements by defining complex products that were difficult to administer. "We are contractually cushioned from the consequences of our actions," Owen explains. "If we introduce a new product that's great for customers but an operational nightmare, our provider pays the price. We learned to sit down together and work through the implications so we could make the right decision from a 'whole of business' perspective."

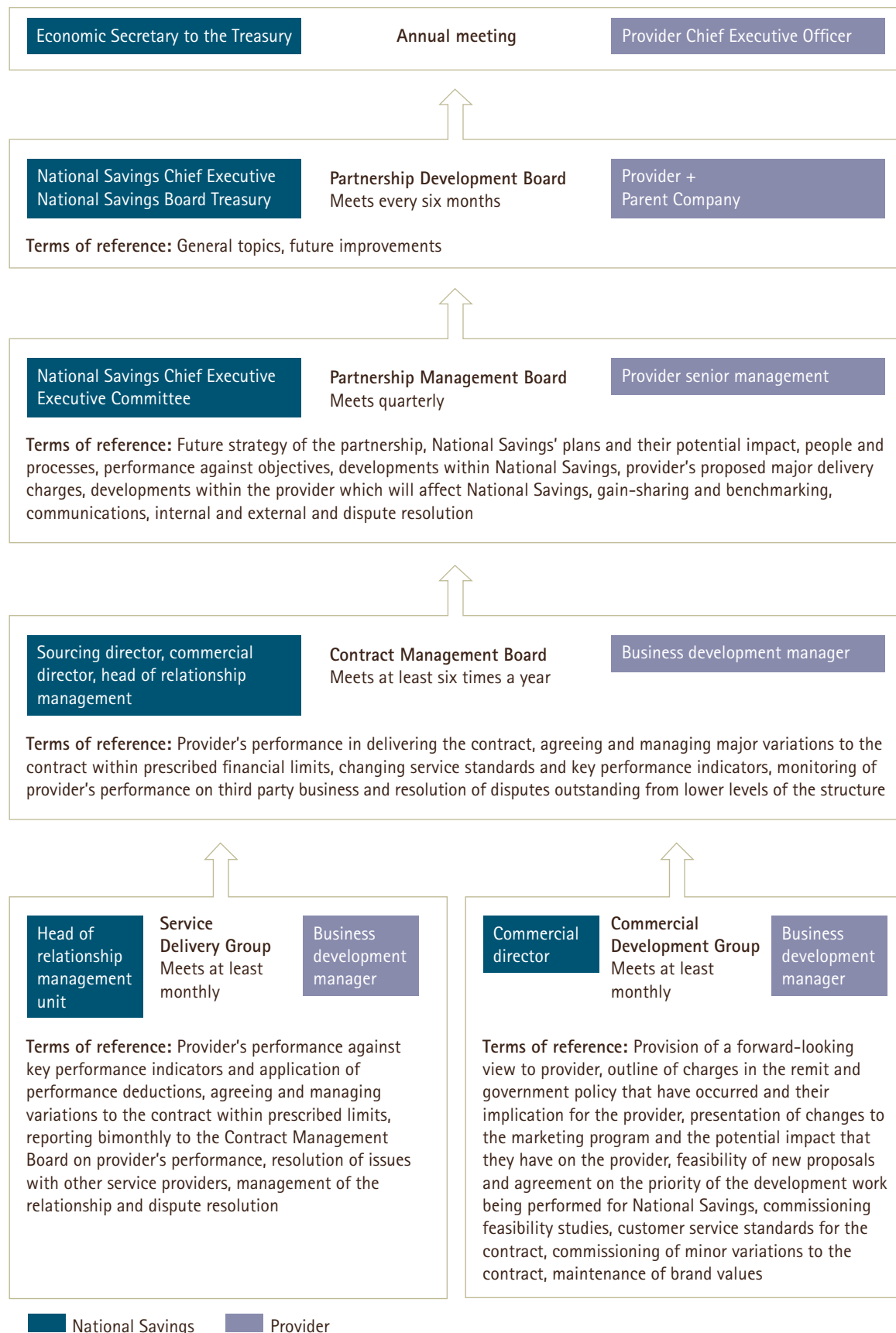
An extraordinary success

In the words of the National Audit Office, NS&I had secured a very good deal with the provider.

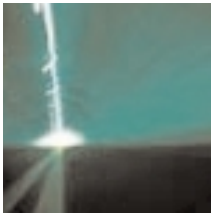
In just four years after transitioning operations to its provider, Bareau and his team had delivered:

- £176 million value added in 2001/2002, against a goal of £120.
- Introduction of the first ever equity-linked investment product, the guaranteed equity bond, which offers a return linked to London's FTSE 100 index yet provides 100 percent security for capital.
- Establishment of a single telephone number for sales and 24x7 service, with the ability of customers to buy seven different products with a debit card over the phone.
- 1.7 million call-center calls, a 57 percent increase over the previous year. Nearly 90 percent of them were answered first, and within 20 seconds, by a person, rather than a machine.
- Launch of a free lost-funds tracing service, which enabled 2,400 customers to be reunited with £3 million.
- Transition of products to a common systems infrastructure.
- Adoption of a new name and modernized identity for the organization.
- Change from an "isolationist, civil service culture" to a market-led culture.
- Change from a complex civil service pay structure to a discretionary system with clear bonuses based on performance.
- Reduction of staff from 4,153 to 2,050 to create a lean, low-cost operation.
- Establishment of a working group with the governments of Canada, the United States and Ireland to benchmark the best practice cost and service levels for public-sector operations that sell retail debt.

Figure 9. Illustration of the governance structure of the NS&I/provider relationship.



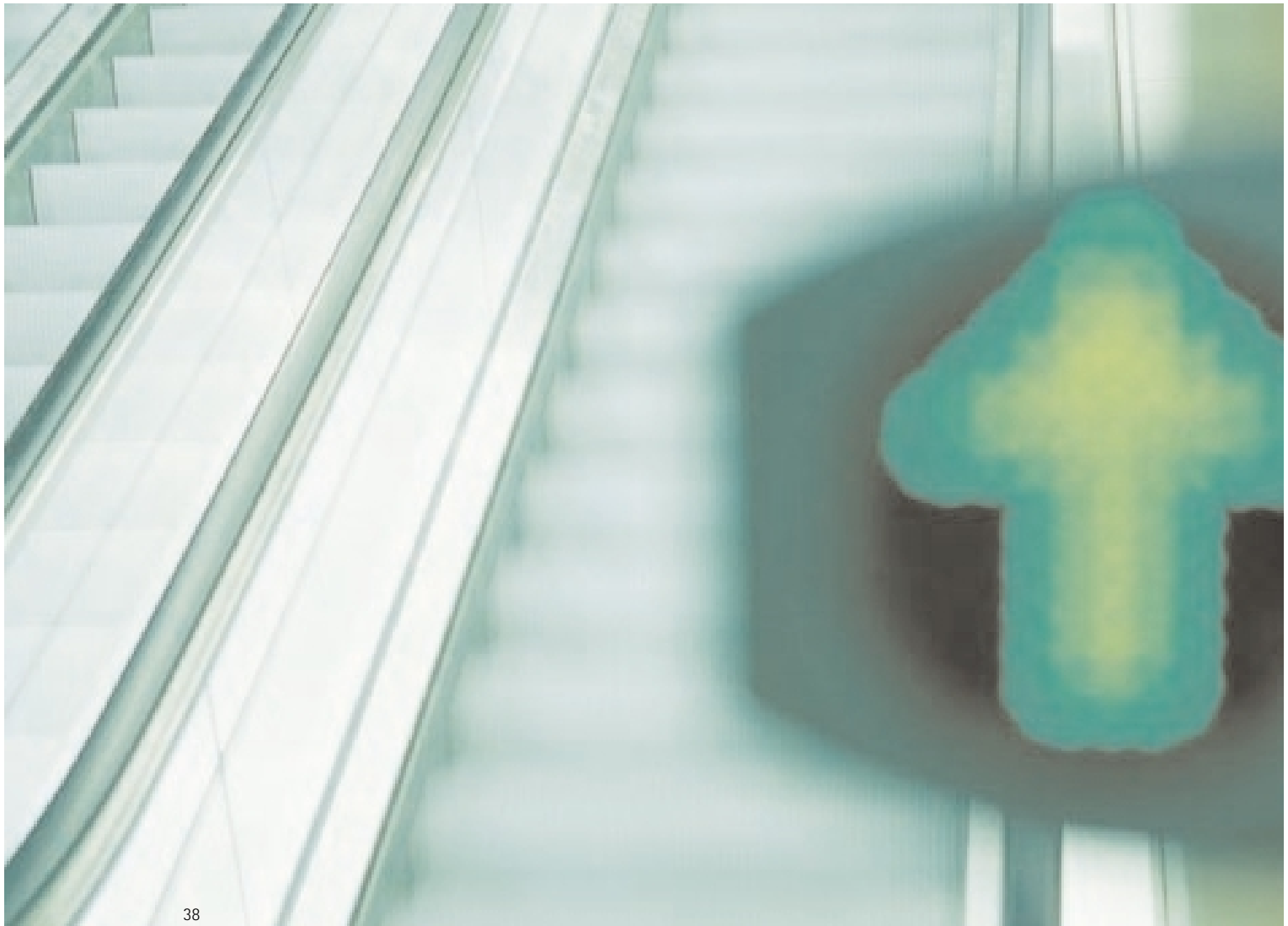
Source: National Savings



Transformation in action: National Savings and Investments

The rewards of transformational thinking

In some ways, Owen asserts, their task was easier than functional outsourcing. "We were business oriented. We described the kind of business we wanted to be and the outputs we were after. You don't need reams of technical parameters and excruciatingly detailed definitions of business interfaces with this kind of deal. And we didn't have to be constrained by what was doable. We just sketched out what we wanted." Bareau attributes their overall success to the partners' commitment, saying, "This was a seminal contract for our provider. We got their absolute, top-level commitment. Without that, we might have found ourselves with much bigger problems. It carries you through the rocky places."



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The Government Executive Series

Outsourcing in Government: Pathways to Value

May 2003

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